

PROXY VOTING BY ASSET MANAGERS: *CURRENT TRENDS AND ISSUES*

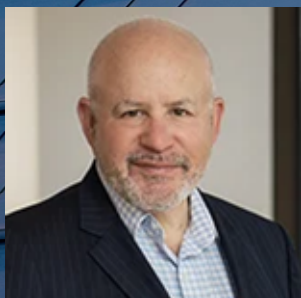
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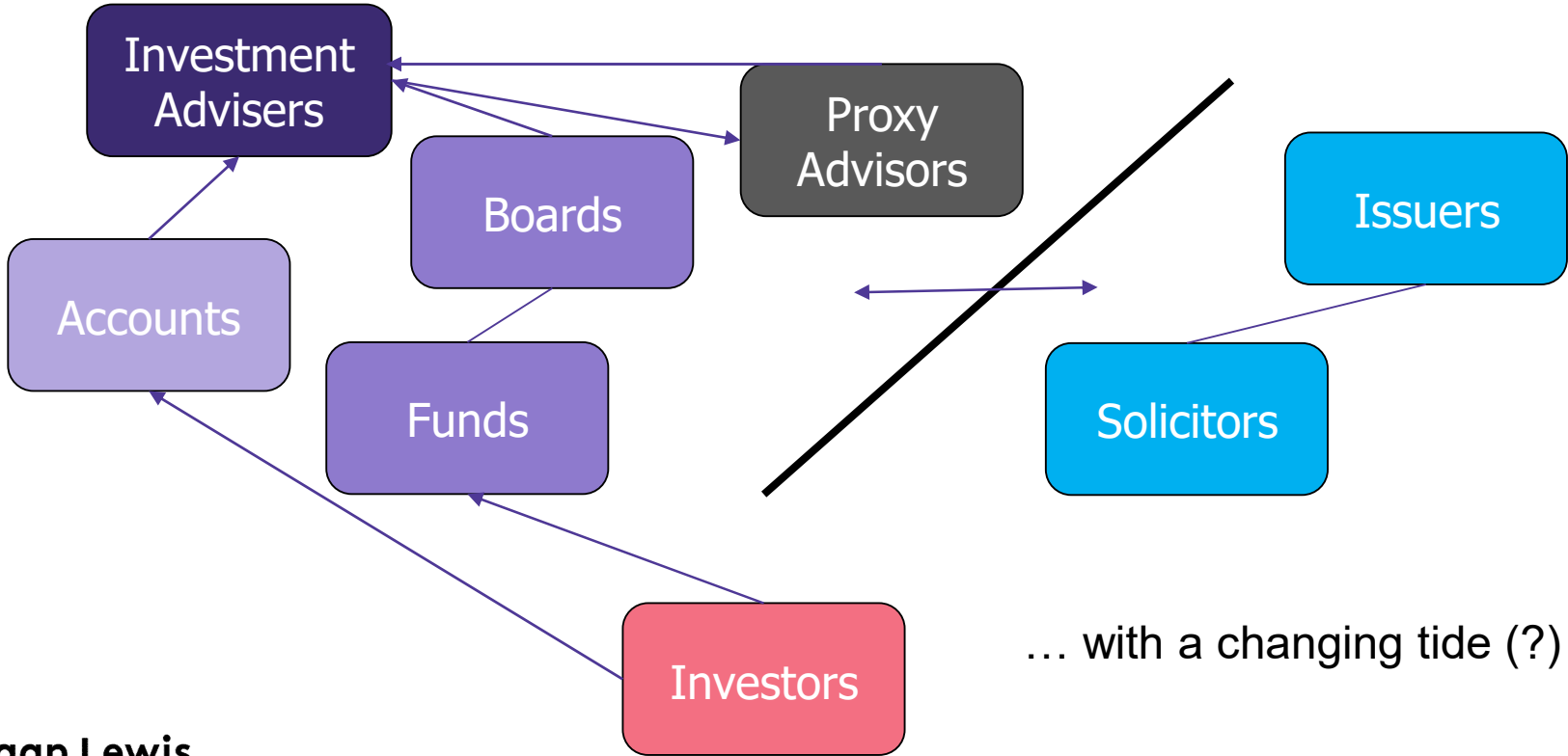
Agenda

- **Proxy Voting Trends and Issues**
 - Regulatory Background and Landscape
 - Proxy Voting and ESG
 - Pass-Through Voting
 - Fund Boards' Focus on Proxy Voting
 - Corporate Issuers: Trends and Predictions
 - State & Federal Scrutiny and Antitrust Considerations
 - Proxy Voting Compliance Considerations
 - Looking Ahead

Regulatory Background and Landscape

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A Large & Complicated Market



... with a changing tide (?)

Regulatory Background

- Investment Advisers
 - Rule 206(4)-6 (adopted 2003)
 - Policies & Procedures, Disclosure, Conflicts
 - July 2010 Concept Release, June 2014 SEC Staff Legal Bulletin No. 20
 - September 2018: IM Information Update and Rescission of No-Action Letters
 - August 2019 SEC Guidance; July 2020 Supplement to SEC Guidance
- Registered Investment Companies
 - Disclosure of Policies & Procedures
 - Disclosure of Actual Voting Practices: Rule 30b1-4 and Form N-PX
 - Board delegation to primary adviser, with duty of continuing oversight
 - Fiduciary Duty and State Law Requirements: Best Interests of Shareholders
- Department of Labor Overlay: November 2022 Rule
- Proxy Advisory Firms: Role and Regulated Status

Proxy Proposals – Issuer Perspective

- **Historically:**
 - Director Elections
 - Auditor Selection
 - SEC-Mandated Voting (e.g., say-on-pay)
- **Today:**
 - More shareholder proposals
 - More variety in proposal types

Shareholder Proposals: SEC Rule 14A-8

Enables shareholders of public companies to submit proposals to be included in the annual proxy statement and to be voted on at the annual meeting:

- Sliding-scale requirement of a minimum amount of ownership (\$2,000 to \$25,000) over a one-, two-, or three-year period of time

Company can seek to exclude a proposal on either procedural or substantive grounds as specified in Rule 14a-8

- SEC arbitrates with a no-action letter process

Proposals tend to fall into the following categories:

- Business practices – 14a-8(i)(7)
- Environmental
- Social
- Governance
- Executive compensation

Shareholder Proposals – Recent Developments

Staff Legal Bulletin 14L (November 3, 2021)

- Rescinds staff legal bulletins 14I, 14J, 14K refocuses “ordinary business” exception for proposals raising significant social policy issues on the policy issue, rather than impact on the company
- Board analysis no longer expected; micromanagement exception curtailed
- Economic relevance exception inapplicable for proposals that raise issues of broad social or ethical concern related to the company’s business

SEC Rule Proposal (July 13, 2022)

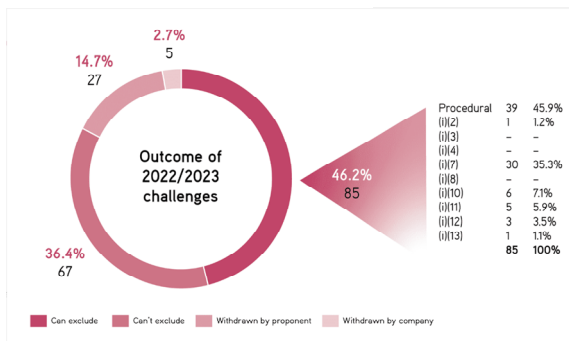
- To revise three of the substantive bases for exclusion of shareholder proposals:
 - substantial implementation exclusion
 - duplication exclusion
 - resubmission exclusion

SLB 14L has made it more difficult to challenge many proposals, particularly for those related to environmental and social issues.

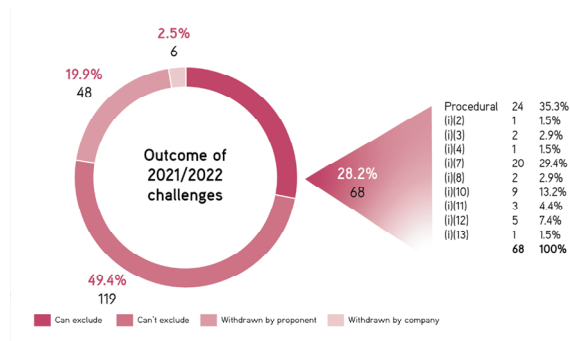
The SEC’s proposal would make it more difficult to exclude certain kinds of proposals.

Shareholder Proposals – Challenges to Inclusion

Outcome of 2022/2023 challenges



Outcome of 2021/2022 challenges



- Challenges were down year-over-year by 24%, from 241 to 184
- For those proposals that were challenged this season, the SEC allowed exclusions at a higher rate (46% vs. 28%) and a greater number (85 vs. 68)
- Procedural exclusions were up as a percentage of all exclusions (46% vs. 35%) and in absolute number (39 vs. 24)
- 14a-8(i)(7) "business process" exclusions were up as a percentage of all exclusions (35% vs. 29%) and in absolute number (30 vs. 20)
- The percentage of proposals withdrawn was in line with last season

Shareholder Proposals – Challenges to Inclusion

- NCPPR sues the SEC in the Fifth Circuit (April 18, 2023)
 - SEC allowed exclusion of NCPPR’s proposal submitted to Kroger
 - Modelled after a 2019 CorVel proposal that the SEC ruled should be included
 - Raised the potential risks associated with omitting “viewpoint” and “ideology” from its written equal employment opportunity (EEO) policy
- NCPPR argues:
 - viewpoint discrimination under the First Amendment
 - arbitrary and capricious agency action
 - action in excess of the SEC’s statutory authority under the Exchange Act
 - incorrect application of Rule 14a-8(i)(7)
- National Association of Manufacturers (NAM) has intervened, making broad First Amendment arguments against the 14a-8 process
- SEC motion to dismiss is pending
 - Is the SEC no-action letter an appealable final order?
 - Is this case moot because Kroger ultimately included NCPPR’s proposal?

Recent SEC Rulemakings

- **Proxy Voting Advice (2020-2022)**

- Regulatory ping pong – addresses the role of proxy voting advisory businesses (PVABs)
- 2022 amendments rescinded 2020 rulemaking before it went into effect
- Removal of conditions to exemptions that PVABs rely on to avoid the proxy rules' information and filing requirements

- **ESG Disclosure Rule Proposal (May 2022)**

- The definition of an “ESG Focused” fund includes an engagement prong
- Proxy voting on ESG matters put on equal footing to investment practices
- Prospectus disclosure and annual report reporting requirements

Proposed Prospectus Disclosure Chart

Overview of the Fund's [ESG] strategy	The Fund engages in the following to implement its [ESG] strategy: <ul style="list-style-type: none"><input type="checkbox"/> Tracks an index<input type="checkbox"/> Applies an inclusionary screen<input type="checkbox"/> Applies an exclusionary screen<input type="checkbox"/> Seeks to achieve a specific impact<input type="checkbox"/> Proxy voting<input type="checkbox"/> Engagement with issuers<input type="checkbox"/> Other
How the Fund incorporates [ESG] factors in its investment decisions	
How the Fund votes proxies and/or engages with companies about [ESG] issues	

Recent SEC Rulemakings (cont.)

- **Amendments to Form N-PX – Final Rule**

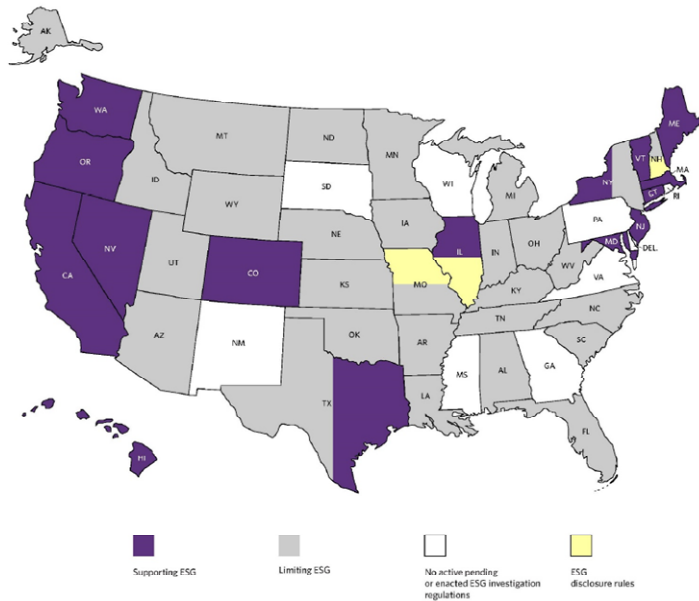
- Adopted in November 2022 – impacts 2024 N-PX filings
- Changes to format of proxy voting reporting (iXBRL)
- Establishes categories for all proxy votes:

Director elections	Compensation
Section 14A say-on-pay votes	Corporate governance
Audit-related	Environment or climate
Investment company matters	Human rights or human capital/workforce
Shareholder rights and defenses	Diversity, equity, and inclusion
Extraordinary transactions	Other social issues
Capital structure	Other (along with a brief description)

Proxy Voting and ESG

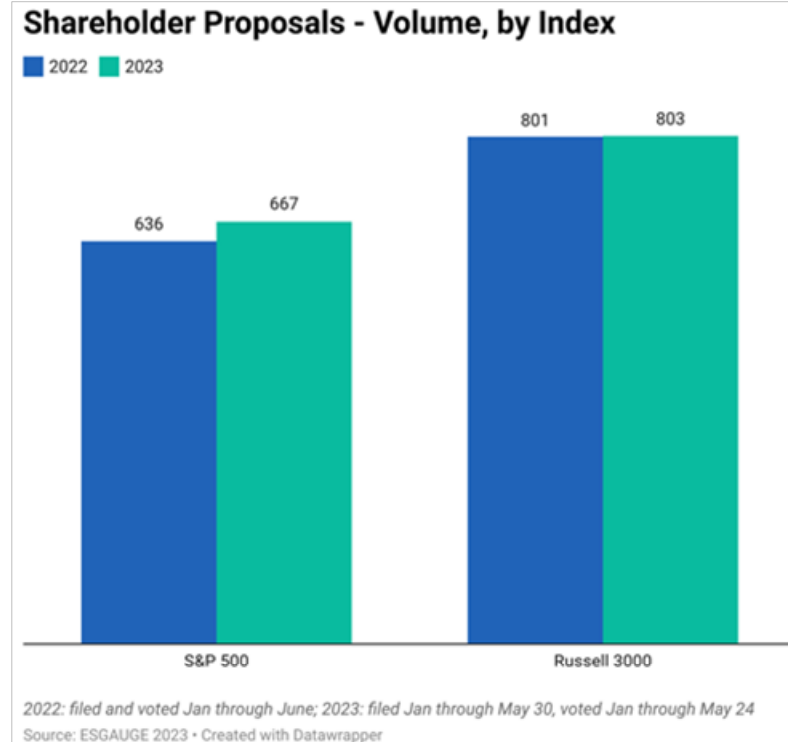
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State ESG Focus on Proxy Voting

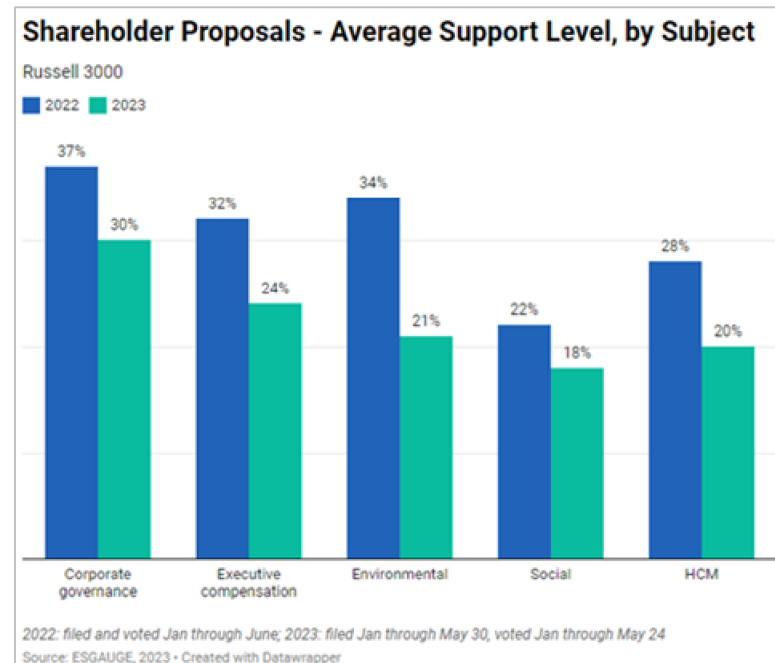
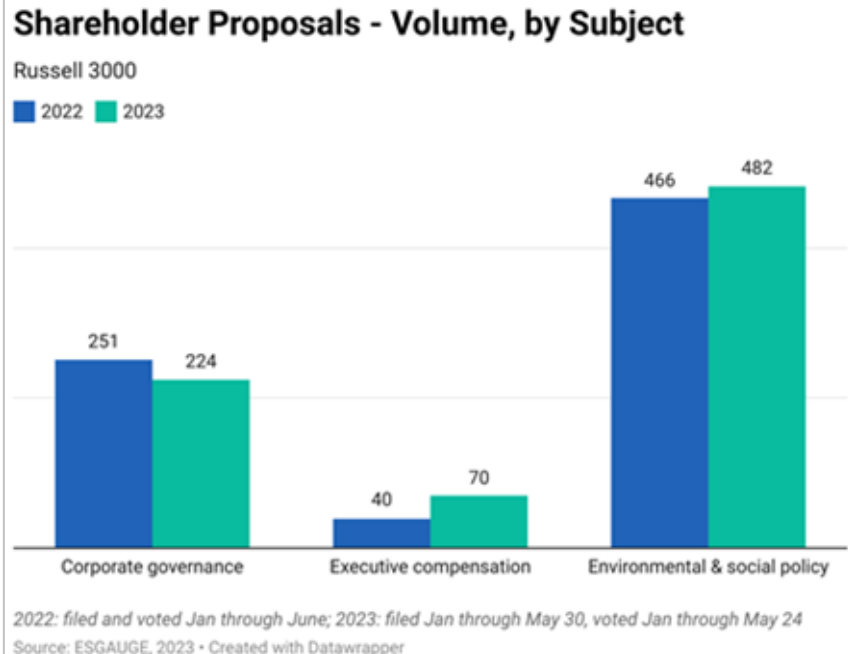


- ESG investing – political hot button issue
- States regulating proxy voting in two ways
 - Directly: legislation specifically regulating proxy voting (e.g., AR H.B. 1253)
 - Indirectly: investigations requiring disclosure of proxy voting (e.g., Texas verification request sent 07/2023)

2023 Proxy Season – Shareholder Proposals Volume



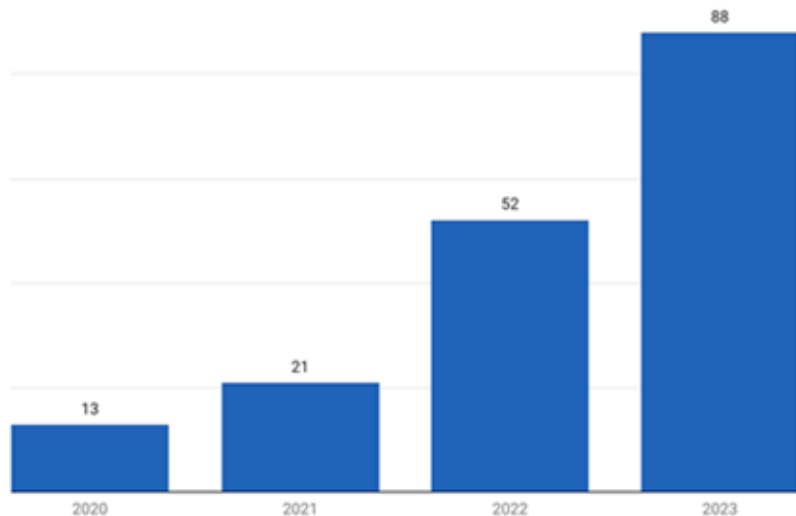
2023 Proxy Season – Shareholder Proposals by Subject



Anti-ESG Proposals

Number of shareholder proposals by anti-ESG proponents

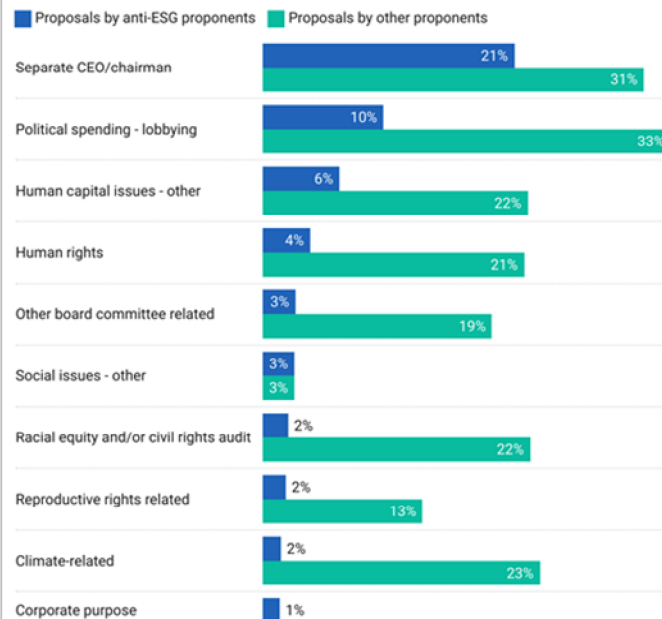
S&P 500



Proposals tracked from National Center for Legal and Policy Center, National Center for Public Policy Research, Steven Milloy, Bahnsen Group, David Bahnsen, Inspire Investing, and William Hild.

Source: ESGAUCE, 2023 - Created with Datawrapper

Average support level: Anti-ESG proponents vs other shareholder proponents (S&P 500)



Proposals tracked from National Center for Legal and Policy Center, National Center for Public Policy Research, Steven Milloy, Bahnsen Group, David Bahnsen, Inspire Investing, William Hild

Source: ESGAUCE, 2023 - Created with Datawrapper

Shareholder Proposals – Outcomes

2022-2023 Voting Results

Category	Total Submitted	Approved	Not Approved	Withdrawn	Success Rate
Business practices	16	2.5%	1	14	6.3%
Environment	90	14.0%	3	78	3.3%
Social	273	42.5%	5	228	1.8%
Governance	203	31.6%	19	161	9.4%
Executive comp	60	9.3%	2	52	3.3%
Total	642	100.0%	30	533	4.7%

2021-2022 Voting Results

Category	Total Submitted	Approved	Not Approved	Withdrawn	Success Rate
Business practices	36	6.3%	7	28	19.4%
Environment	65	11.3%	14	50	21.5%
Social	200	34.9%	17	179	8.5%
Governance	239	41.7%	41	195	17.2%
Executive comp	33	5.8%	5	26	15.2%
Total	573	100.0%	84	478	14.7%

- More proposals this season; social proposals up by 37%
- But fewer proposals are getting approved

Shareholder Proposals – Voting Outcomes

Season	Proposal type	Submitted	Approved	Not Approved	Withdrawn	Success Rate
Business practices						
2022-2023	Employment agreement concealment clauses	0	~	~	~	~
2021-2022	Employment agreement concealment clauses	8	4	4	0	50.0%
Environment						
2022-2023	Emission reduction	30	0	27	1	0.0%
2021-2022	Emission reduction	30	10	19	1	33.3%
Social						
2022-2023	Racial equity audit	16	0	14	2	0.0%
2021-2022	Racial equity audit	17	3	14	0	17.6%
Governance						
2022-2023	Special meeting-related	43	5	35	0	11.6%
2021-2022	Special meeting-related	107	10	97	0	9.3%
Executive comp						
2022-2023	Shareholder approval of termination pay	40	2	35	0	5.0%
2021-2022	Shareholder approval of termination pay	14	5	8	1	35.7%

- Shows a representative proposal type for each major category
- Shareholder support has dropped significantly for most proposal types

Pass-Through Voting

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What Is Pass-Through Voting?

- Pass-through voting generally refers to the concept of allowing a fund's shareholders to participate in determining how the fund should vote proxies issued by companies in which the fund invests ("portfolio companies").
- Pass-through voting can be implemented using a number of different models, alone or in combination:
 - Direct Control
 - Proxy Policy Selection
 - Ballot Item Polling
 - General Proxy Polling
 - Hybrid Approach

Potential Motivations for Pass-Through Voting Adoption

- Allow fund shareholders to determine how to wield the fund's substantial influence.
 - Maximizing financial benefits vs. addressing ESG concerns.
- Further mitigate investment adviser conflicts of interest.
- Reduce perceived problems associated with common corporate ownership.
- Anticipation of legal or regulatory mandates.
 - INDEX Act.

Pass-Through Voting Considerations

- Fund Board's Role
 - Determine whether the establishment of a pass-through voting program is in the best interest of the fund.
- Fund Organizational Documents
 - Should be examined to ensure that they do not include any provisions that would impede the adoption of a pass-through voting program and amended if necessary.
- Investment Advisory Agreements
 - Should be appropriately tailored to account for the operational realities of the specific pass-through voting program.
- Disclosure Obligations
 - Pass-through voting programs should be described in fund's registration statements and elsewhere.

Pass-Through Voting Considerations (cont.)

- 1934 Act Proxy Rules
 - Funds should take care to ensure that their pass-through voting programs do not give rise to a proxy solicitation under the 1934 Act.
- Compliance Procedures
 - Fund compliance programs will likely need to be tailored to account for the implementation of a pass-through voting program.
- State Law
 - Funds should consider applicable state laws with respect to who owns the right to vote a security and whether state law imposes any obligations on fund shareholders with respect to each other.
- Operational Concerns
 - Ensuring broad shareholder participation.
 - Record dates and pass-through eligibility.
 - Foreign securities.

Fund Boards' Focus on Proxy Voting

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Fund Boards' Focus on Proxy Voting

- Boards have ultimate authority over the proxy voting of funds
- This responsibility can be (and typically is) delegated to the Investment Adviser, sub-advisers, proxy advisory firms
- Board retains oversight responsibility
- Increasing focus from SEC (and other regulators) on proxy voting, coupled with increasing focus from shareholders (with more transparency and in response to changing investment motivations), has resulted in many Boards revisiting current procedures
 - Educational sessions from operations teams and counsel

Corporate Issuers: Trends and Predictions

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Influence of ISS and Glass Lewis on Voting by Asset Managers

Shareholder voting is dominated by institutional investors. Broadridge and PricewaterhouseCoopers (2017) show that institutional investors—such as mutual funds, index funds, pensions, and hedge funds—own 70% of the outstanding shares of publicly traded corporation in the United States. Individual (or “retail”) investors own only 30%. Institutional investors also have significantly higher voting participation rates, casting votes that represent 91% of the shares that they hold compared with only 29% for retail investors. The combination of these factors gives institutional investors a disproportionately large influence over voting outcomes.

[The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry \(harvard.edu\)](#)

Influence of ISS and Glass Lewis on Voting by Asset Managersv (cont.)

- There is considerable evidence that proxy advisory firms influence proxy voting outcomes. Nevertheless, there is disagreement about the *degree* to which they influence these outcomes.
- The reason is largely due to measurement: It is impossible to know how institutional investors *would have voted* on the same ballot if proxy advisors did not issue a recommendation or if they made a different recommendation. Furthermore, it is impossible to know the degree to which institutional investors take into account *the same information* that ISS and Glass Lewis use to arrive at their recommendations, thereby reaching the same conclusion about how to vote on specific issues.

[The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry \(harvard.edu\)](#)

Influence of ISS and Glass Lewis on Voting by Asset Managers (cont.)

- Earlier research has identified the prevalence of robovoting among institutional investors in line with ISS more than 90% of the time.
- Recent research confirms “strong influence,” with negative recommendations from ISS or Glass Lewis reducing clients’ votes by more than 20% in both director elections and say-on-pay proposals.
- Many funds—particularly those that are not able to afford extensive in-house corporate governance teams, due to small size or cost-sensitive business models, such as passive index funds—will tend to outsource their governance to proxy advisors.

[Proxy Advisors And Market Power: A Review of Institutional Investor Robovoting \(harvard.edu\)](#)

Key 2023 Proxy Advisory Changes at a Glance

- 2023 updated ISS and Glass Lewis voting policies primarily concerned:
 - Director diversity and overboarding
 - Board oversight of environmental and social issues
 - Oversight of cyber-related risks
 - Board accountability, including for climate-related issues
- Updated ISS and Glass Lewis policies expected in November 2023 for the 2024 proxy season.

Universal Proxy Cards

For proxy cards in contested director elections:

- Intended to replicate voting options available for in-person voting at shareholder meetings
- Required formatting of proxies to neutrally identify and present management and dissident nominees
- Dissidents required to solicit at least 67% of voting power
- Parties will continue to file their own proxy statements

Notice requirements:

- Dissident notice 60 days before anniversary date of prior year's meeting
- Company notice 50 days prior to anniversary date of prior year's meeting
- Dissident proxy filing by later of 25 days prior to meeting and five days after company filing

Effective for shareholder meetings held after August 31, 2022

Universal Proxy Cards (cont.)

- Implemented by new Rule 14a-19(e)
- *Universal proxy cards* must include the names of both registrant and dissident nominees “and thus allow shareholders to vote by proxy in a manner that more closely resembles how they can vote in person at a shareholder meeting”
- [Final release 34-93596](#) (November 17, 2021)
- [Press release](#)
- [Fact Sheet](#)
- [Proposal release 34-79164](#) (October 26, 2016) [Fed Reg version](#)
[Comment letters](#)

State & Federal Scrutiny and Antitrust Considerations

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State Scrutiny of Proxy Advisory Firms

- **Attorneys General letter to ISS & Glass Lewis (Jan. 2023)**
 - Alleging that the firms “have made several commitments that may interfere with your ability to honor your legal obligations”
 - Net-zero; boardroom diversity
 - Similar letters sent to asset management, insurance, and financial service provider industries alleging that net-zero and other ESG-related commitments may violate fiduciary duty and antitrust laws
- **State Treasurers letters to ISS & Glass Lewis (May and October 2023)**
 - Criticizing proxy advice regarding ESG matters as being “untethered to shareholder value”
 - Raising concerns with lack of disclosure of data on vote recommendations and alleged politicization of ESG-related voting recommendations

Federal Scrutiny of Proxy Advisory Firms

- **Proposed Legislation in Congress**

- HR 4767, the Protecting Americans' Retirement Savings from Politics Act
 - raises resubmission thresholds for shareholder proposals; limits the SEC's ability to define a "major policy issue"; allows companies to exclude environmental, social, and political proposals; prohibits robovoting; requires proxy advisory firm clients to issue annual public reports on their proxy voting; requires large asset managers to conduct economic analysis when voting against board recommendations; requires investors to consent to the use of non-pecuniary factors in decision-making
- HR 5337, the Retirement Proxy Protection Act
 - Not all proxies must be voted (only those that promote financial interest/goals of the plan)
 - If delegating proxy voting to a third party, fiduciaries must retain records and prudently monitor proxy voting activities

Proxy Advisory Firms Respond to Pressure

- Revising the factors used to determine ESG-related ISS QualityScores
- ISS gives scores of 1-10 based on a wide set of factors
 - Updated Factors for Governance QualityScore announced 10/25/2023
 - New or expanded factors related to board structure, compensation, audit, risk oversight, and shareholder rights.
 - Updated Environmental & Social Disclosure QualityScore expected soon
 - New or expanded factors expected to relate to workforce diversity and equality, gender pay gap factors, labor relations and occupational health disclosures, and carbon- and climate-related disclosures.

Proxy Voting Compliance Considerations

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Compliance Considerations

- Proxy voting and engagement audit
- Policies and procedures
- SEC Rule implementation and considerations
- Recordkeeping
- Proxy oversight committee
- Vendor oversight
- Sub-adviser delegation/15(c) implications
- Disclosure – N-1A requirements

Looking Ahead

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On the Horizon

- **SEC Activities**
 - Rulemaking?
 - Implementation of N-PX reporting
- **State Regulators**
 - Increased focus? Inquiries?
- **Legislators**
 - Continued focus on proxy advisory firms
- **Predictions for Issuers**

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THANK YOU

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